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C O N F I D E N T I A L BUENOS AIRES 002202

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PASS NSC FOR JOSE CARDENAS
PASS FED BOARD OF GOVERNORS FOR PATRICE ROBITAILLE
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SUBJECT: ARGENTINA'S PRICE CONTROL CZAR - A TRUE BELIEVER

Classified By: EconCouns D.P.Climan. Reasons 1.5 (B,D)

Summary

11. (C) GoA Secretary of Domestic Trade Guillermo Moreno, President Kirchner's designated price control enforcer, justifies a GoA mix of export tariffs, export controls and strong-arm populist price controls as a means to correct monopolistic behavior and oligopolistic collusion in Argentina's small and uncompetitive domestic market. Market analysts broadly agree that the GoA's price control model will restrain headline inflation through planned October 2007 elections. There is also consensus that the GoA will eventually have to tackle inflation via a more orthodox policy mix, including less expansive fiscal and monetary policies. Separately, Moreno called President Kirchner's engagement with Venezuelan President Chavez a matter of strategic convenience, with the GoV supporting Argentina's return to international capital markets and with Venezuela's membership in Mercosur offering a counterweight to Brazil's massive economic hegemony in the bloc. End Summary

Micro Economic Imperative for GoA Price Controls

12. (SBU) EconCouns met September 21 with Secretary of Domestic Trade Guillermo Moreno. In a wide ranging defense of the GoA's price control regime, Moreno stressed that his thoughts reflect directly the instructions of Planning Minister DeVido and the broad policy orientation of President Kirchner.

13. (C) The U.S.' ultra competitive "law of the jungle" markets, our "relatively open" trade regime, and our even-handed enforcement of anti-trust regulation ensure U.S. consumers are treated fairly, Moreno argued. The GoA, however, struggles with an entirely distinct Argentine market dynamic, one in which limited domestic market size promotes the development of monopolistic profit maximizing behavior and oligopolistic collusion. As a consequence, the GoA works to overcome these market distortions not via price controls ("There are no price controls in Argentina and those who say there are impugn the credibility of the State!") but rather via "active monitoring" of sector- and company-specific cost structures in order to ensure companies remain "appropriately and reasonably" profitable. Companies must remain profitable to produce, Moreno emphasized, and the State will ensure they remain so. But profitable companies have an obligation to invest, gain scale economies and pass on unit cost savings to consumers. Companies that engage in "cold-hearted" analyses of consumer price elasticity of demand and curtail output accordingly to maximize profit, are not serving their social mandate and will not be tolerated.

Economic Heterodoxy and the Argentine Economy

14. (C) Argentina's extraordinary economic growth in the four years since the December 2001 default speaks for itself, Moreno said. While demographics and overall poverty indicators continue to lag, sustained economic growth has allowed Argentina to surpass its prior 1998 GDP peak. President Kirchner's goal is to maintain this growth, Moreno

emphasized, while reducing and containing domestic inflation to single digit levels. "My mandate is to meet this goal and I will use every means at my disposal to ensure that Argentina's poor -- and almost 1/3 of us still live below the poverty line -- continue to see their purchasing power increase." The secret to political harmony in Argentina, Moreno, concluded, is straightforward: The average Argentine family will support a government that provides the wherewithal to have a "parrillada" (traditional Argentine barbeque) once a week; to buy clothes twice a year; and to go on vacation to the beach once a year. "Its just that simple -- and we are delivering the goods!"

Mercosur Expansion and GSP

15. (C) Unprompted, Moreno called U.S. concern at President Kirchner's increasingly close ties with Venezuelan President Chavez unnecessary: Kirchner's engagement with Chavez is wholly a matter of strategic convenience, as he is helping support the GoA's re-entry into the international debt security market (Note: Approximately USD 4 billion to date. End Note), with quasi-private placements issued to the GoV now trading actively in global secondary markets. Argentina supported Venezuela's entry into Mercosur largely as a counterweight to Brazil's massive economic hegemony in the bloc. Argentina, Moreno emphasized, will not allow itself to be dominated by Brazilian markets and production economies and will use Mercosur safeguard mechanisms as needed to protect Argentine production and jobs.

16. (C) Moreno noted recent local media reports that the U.S. intends to remove Argentine GSP privileges in retribution for Argentina's intransigence in the June 2006 Geneva WTO talks and President Kirchner's manifest lack of support for the FTAA at the November 2005 Mar de Plata Summit. He agreed that the U.S. has every right to modify its unilateral trade benefits as it sees fit. "We are not asking for preferential access to U.S. markets," he said, "but rather we seek a signal that you will open your markets to our economic strengths by coming to terms with your protectionist

agricultural subsidies. Such massive U.S. agricultural sector inefficiency at such a great cost to your taxpayers...and you call our Argentine economic heterodoxy distortionary!"

Comment

17. (C) Though Domestic Economy Secretary Moreno works in the Ministry of Economy and Production and so nominally reports to Economy Minister Miceli, he openly disparaged Miceli as a lightweight and stressed that he is Planning Minister De Vido's man in the Economy Ministry. Moreno stressed that he speaks for the Planning Minister who, in turn, reflects the "spirit" of President Kirchner's economic development philosophy.

18. (C) Moreno is clearly a true believer in his price control mandate. Certainly the distinction he makes so forcefully between actively managed price controls and a guided cost-plus pricing regime appears to be more nuanced than substantive: The Kirchner administration has sought to control "canasta basica" (primary consumption basket) prices

via a mix of export tariffs, export controls and strong-arm populist tactics, including President Kirchner's personal call for a boycott of Shell when it raised gasoline prices at the pump in 2005. Moreno's reputation among U.S. multinationals is poor: Merck tells us he threatened to send piqueteros (street protesters) to disrupt their operation if Merck failed to roll back drug price increases; Exxon says Moreno threatened to send a disruptive inspection team to review the company's books if Exxon did not lower pump prices and then make statements to the media supportive of GoA price control efforts; CMS Energy recounts that Moreno reviewed the company's offer price to sell CMS' stake in a major natural gas pipeline company and insisted CMS drop it by 75% as a basis to begin negotiations; and other executives recount meetings held with Moreno to reach sector specific price standstill agreements where Moreno opened the meeting by placing a gun on the table.

19. (C) The GoA believes that its price control regime is an appropriate response to an Argentine macroeconomy in which current inflation is being driven by an adjustment in the relative price of non-tradeables, a result of the massive 2002 depreciation. In their view, this catch up will generate inflationary pressure only until the economy transitions to a new post-crisis steady state and GoA price controls will prevent temporary inflation pressures from becoming embedded in expectations and wage pressures. However, many analysts here argue that Argentina's inflationary dynamics are not as transitory as the GoA believes. Instead they see Argentine inflation being driven by rapid domestic demand growth fueled by a stimulative macro policy. Analysts point to INDEC (the GoA's statistical agency) data that show price increases have been broad based, that capacity utilization is high and that unemployment (though structurally high) is currently lower than at any point since the early 1990s. If Argentina's inflation is being generated by these more permanent factors -- and Post believes this is the case -- then continued GoA delays in tackling its root causes increases both the risk of macroeconomic volatility and the eventual economic cost of squeezing out inflation. Sooner or later, the GoA will have to begin addressing inflationary pressures via less expansive fiscal and monetary policies.

110. (C) To be fair, many of our contacts in the Kirchner administration quietly share this view. But they remain confident that the GoA's current price control model will suffice to restrain headline inflation through planned October 2007 elections. The Kirchner administration, they confide, has simply not fleshed out a longer term strategy for dealing with inflation and remains content to reap short

term political advantage from the populist rhetoric that accompanies price controls. This may well serve the Kirchner administration through upcoming elections. But the eventual cost to Argentina, in terms of economic instability, micro-level distortions and inefficiency, and ultimately growth forgone, will be high. End Comment.

MATERA